Unveiling the financial nexus: Analysing the impact of capital structure on selected companies

SHORT SYNOPSIS

Submitted in partial fulfillment of the requirement of the degree of

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by

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Certificate

I hereby declare that the short synopsis Titled "**Unveiling the Financial Nexus: Analyzing The Impact of Capital Structure on Selected Companies**" submitted in partial fulfillment of the requirement for the degree of Doctor of Philosophy in Management under the School of Leadership And Management of Manav Rachna International Institute of Research & Studies, Faridabad during the academic year 2023-2024. It is a bona fide record of original work carried out under the supervision of Dr. Rashmi Singel and Dr. Harjit Singh and has not been submitted in full or part to any other university or institute for a degree or diploma. Further, it is certified that the short synopsis is plagiarism-free, and proof has been submitted.

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ABSTRACT

The combination of stock and loan finance that a firm has is called its capital structure. It lays forth how a business's operations are financed. There is a greater ratio of debt to equity in a highly leveraged corporation. The opposite is true for low-leveraged companies: those with a lot more stock than debt.

Financial leverage affects a company's performance, management must, therefore, choose an appropriate capital structure plan, bearing in mind the hazards and costs associated with equity and debt financing. Better returns for the business are possible with a well-managed capital structure.

Determining the nature of the connection between available organizations' debt-equity ratios and several financial performance, solvency, profitability, and turnover metrics across several different sectors. Automobiles, Fast Moving Consumer Goods, Information Technology, Oil and Gas, and Pharmaceuticals are the chosen enterprises. To learn how capital structure affects the bottom lines of businesses in certain sectors, we'll use regression and correlation analysis.

Keywords: Capital Structure, Financial Performance, Risk, Liquidity, Profitability

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I. INTRODUCTION

Every firm needs capital to launch, grow, and diversify; in fact, capital is the lifeblood of every enterprise. Debentures or shares are the two main ways in which businesses raise capital. The purpose of the goal of a business's financial framework is to maximize the market by combining debt and equity. Money may be raised in two ways: either via borrowing it or from the owners themselves. The worth of the business today will be determined by any investments that have strong long-term rewards. This is the sum of the financing cost and the anticipated future cash flows from the investment.

A financial plan, including a number of corporate financial choices, is something that every responsible finance manager does. The financial strategy's many policies, including those pertaining to capital budgeting, dividends, and capital structure. All of these are crucial to any company's decision-making process because of how interconnected and interdependent they are. Decisions must be made continuously about the capital structure, a crucial duty. Its price tag will always be sensitive to changes in the mix of debt and equity. Financing, profitability, efficiency, and solvency are all affected by the capital structure's cost and risk.

Initial work on capital structure came from Modigliani and Miller (1958), who characterized it as a mix of equity and debt financing. Five years after their paper came out, Modigliani and Miller changed their minds about the assumptions they had made about how capital structure affects firm value. Many researchers have persisted in studying the correlation the relationship between a company's capital structure and its performance following the theories of Modigliani and Miller. Research has shown that capital structure and financial performance are inversely related (Mumtaz, 2013; Le and Phung, 2013; Mohammadzadeh SH et al., 2012; Ahmad et al., 2012; Kajola, 2010). Lorpev and Kwanum (2012) found it negligible and negative, however, Badar and Saeed (2013) discovered a direct and substantial association. Therefore, scholars all over the globe are actively trying to figure out how capital structure affects a company's success.

With the assumptions of a perfect market and no taxes world, Modigliani and Miller conducted the first study of the capital structure in the early 1960s. They found that the proportion of debt-equity was independent of the firm's value, a finding that other researchers later confirmed. The two main sources of friction between shareholders and management and debt holders and

equity shareholders were pointed out by Jenson and Meckling (1976). Managers' primary concern, according to agency cost theory, is increasing their wealth rather than that of shareholders. As a result, shareholders take measures to keep an eye on things—which might be costly, often called agency cost—in an attempt to ward off these interests. Two important contributions to the literature on Myers's (1984) Static Trade-off and Myers and Majluf's (1984) Pecking Order Hypothesis were the two main theories about capital structure. The company should establish a hierarchical framework to finance its assets per the Pecking Order Hypothesis. Businesses should use their cash on hand, such as retained profits or other money generated domestically, to finance assets if they need additional funding. Debt and equity capital should be used in that order. The ideal capital structure for a business, according to the trade-off hypothesis, would weigh the pros and cons of debt.

II. LITERATURE REVIEW

Al-Haddad, Saidat, et al (2024) studied the relationship between capital structure and family-owned firms' financial performance in Jordon. A multivariable regression method was used to examine the topic empirically. The findings of this study suggest that family businesses predominantly depend on equity for funding, adversely affecting their financial performance. The study demonstrates a negative correlation between capital structure and the financial performance of family firms.

Brusov & Filatova (2023) analysed different ideas about how companies should manage their debt and equity to make the best financial decisions. It highlighted the importance of finding the right mix to maximize a company's value and achieve long-term goals. It covered theories from the mid-20th century to the present, focusing on the Modigliani–Miller (MM) and Brusov–Filatova–Orekhova (BFO) theories, and their updates. Recent changes made these theories more practical for real businesses, showing that even with its limits, MM could still be useful. However, MM only worked for companies that lasted forever, while BFO was useful for all companies.

Rosdiana, Karyatun & Sekar Sari (2023) aimed to determine how profitability, liquidity, tangibility, size of the firm, and risk affected capital structure. It focused on food and beverage manufacturing companies listed on the Indonesia Stock Exchange from 2014-2018, using a sample of 16 companies. The study found that profitability positively and significantly affected capital structure, while liquidity, tangibility, firm size, and risk had positive or negative but not significant effects.

Adeneye, Kammoun, et al (2023) researched to examine the impact of sustainable practices on capital structure. 116 non-finance firms in five South-Asian countries listed on the stock exchanges were studied. The study found a negative association between ESG scores and market leverage. Environmental, social, and governance scores increased the speed of adjustment (SOA) by about 7.82%, 2.88%, and 0.47%, respectively, compared to traditional SOA without ESG factors. The overall ESG score raised the SOA by approximately 3.41% above the baseline without the ESG factor.

Alwan & Risman (2023) examined the impact of capital structure, financial performance, and company growth on the value of agricultural companies listed on the IDX. It found that a higher Debt to Equity Ratio negatively affected company value, while Return on Assets had a positive effect. Growth in total assets did not significantly impact company value. Data were analyzed using descriptive statistics and panel data from 9 selected companies over 2016-2020.

Dewi, Riswan & Khairudin (2024) In the dynamic food and beverage industry, understanding asset structure and sales growth is crucial for financial management. This study explored how these factors influence capital structure, with profitability playing a mediating role. Using quantitative methods, 23 companies from the IDX food and beverage sector were sampled over 2020-2022. Analysis revealed a positive impact of asset composition and sales growth on capital structure, with profitability serving as a mediator.

Melananda & Irma Sari (2024) This study examined how company size, profitability, and sales growth influenced the capital structure of mining firms on the Indonesia Stock Exchange from 2019 to 2022. 11 companies were sampled through purposive selection. Results showed that company size significantly affected capital structure, with larger firms carrying more debt. However, no notable relationship was found between profitability, sales growth, and capital structure. These findings suggest Indonesian mining companies prioritize company size in capital decisions over profitability and sales growth. Understanding this can aid firms in making informed financing choices.

Fedorova et al (2024) researched understanding the impact of CEO narcissism and optimism on the capital structure under pandemic conditions. The study showed that narcissism had a minor and nonlinear impact on capital structure. During the pandemic, pessimism and uncertainty prompted managers to change strategies significantly. Gender didn't affect median levels of optimism and narcissism among CEOs. Narcissistic CEOs emphasized long-term goals, projects, and their brand.

Chauhan, Verma, et al (2024) studied how capital structure affects the social and financial performance of microfinance institutions (MFIs) with dual objectives. Using panel data from 46 NBFC-MFIs in India from 2013–2019, it found a positive relationship between capital structure and MFI performance, contributing to financial inclusion.

Khadafi, Iyakaremye, Gasheja et al (2024) investigated the impact of capital structure on the financial performance of five Rwandan commercial banks from 2010-2019. It found fluctuating capital structures and financial performance across the banks, indicating no targeted debt-to-equity ratio. Results suggested no significant relationship between financial performance and debt-to-equity ratio, supporting Modigliani and Miller's theory.

III. RESEARCH GAP

This study will be undertaken after analysing the gaps in the earlier studies. Many studies on capital structure were conducted earlier but were limited to one or two sectors. The studies undertaken already focus on one or two variables of financial performance. The present study shall be carried out on five major sector industries: automobiles, FMCG, pharmaceuticals, oil and gas, and IT, and it shall be carried out on multiple variables.

This research aims to re-examine the relationship between capital structure and financial results in the Indian economy. Given the rapid transformation of the regulatory landscape and the dynamics of the Indian market, this research couldn't come at a better moment. There has been a rise in IPOs, bond issuances, and the pursuit of other forms of alternative financing in the country's capital market. Additionally, the government has announced several policy steps to facilitate business and welcome international investment. Results from this research will be more robust and dependable since they will be based on a much bigger sample size than those from earlier studies.

IV. PROBLEM STATEMENT

To find the relationship between the Capital Structure and Financial Performance of selected Indian companies. The metrics used to evaluate financial performance include Liquidity, Profitability, Solvency, and Efficiency. The following hypotheses have been developed.

Ho: Among the sampled businesses, there is no correlation between the capital structure depicted by Debt Equity ratio and the financial parameters depicted by respective liquidity, solvency, efficiency, and profitability ratios.

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V. DESCRIPTION OF BROAD AREAS

A company's capital structure plays a significant role in shaping its financial framework and, by extension, its potential for success. Identifying the optimal debt-equity ratio is a persistent challenge for multinational corporations since it directly affects bottom-line results. The capital structure choice is complex and demands careful consideration. Debt payment becomes difficult if the debt component is raised to boost profits. Having a higher equity ratio also increases the cost of capital. Compared to locally owned enterprises, MNCs in India have preferential access to financial resources. This new information further complicates the already challenging capital structure choice. Choosing an optimal capital structure requires considerable financial acumen, judgment, and understanding.

The study will investigate the effects of capital structure ratio i.e. debt-to-equity, on operational indicators like return on equity, return on assets, and earnings per share, etc. This research hopes to shed light on the connection between the capital structure choices made by multinational corporations in India and their bottom lines.

VI. RESEARCH OBJECTIVES

The study seeks to fulfill the following objectives:

1. To identify the factors influencing the capital structure of selected companies
2. To assess selected companies' capital structure (in the form of Debt Equity ratio).
3. To evaluate selected companies' profitability, liquidity, solvency, and efficiency as measures of financial performance.
4. To examine the relationship between the Capital Structure and financial performance of selected companies.

VII. RESEARCH METHODOLOGY

To answer a research question or test a hypothesis, researchers use a specific set of techniques known as a "research methodology." The structured approach helps researchers organise, carry out and document their studies. A study's methodology is influenced by several factors, including the study's subject, the data to be acquired, and the researcher's available resources.

A researcher's methodology is the collection of steps they take to go from the beginning of their project to the result. It's a strategy for systematically approaching the research problem. This study aims to analyse and make sense of the relationship between capital structure and company performance using a sample of Indian MNCs.

A sample from the following set of companies shall be taken for a period of six years, from 2018 to 2023 (six years is taken into consideration since the Capital Structure changes with the changes in the company's demand for finance). The research will be carried out in the following sectors:

1. Oil and Gas
2. Pharma
3. Information Technology
4. Automobiles
5. FMCG

The above sectors are chosen as these are the top-growing sectors of the Indian Economy (the only exception is Real Estate).

The pharmaceutical industry grew at a rate of roughly 9–10%, with its GDP contribution amounting to 1.5% of India's total GDP. Favourable macro factors, including GDP growth, inflation, and manufacturers passing on the benefits of margin expansion following the GST regime helped the FMCG market expand by 13.8%. The automotive industry in India accounted for approximately 7.5% of the country's GDP, with sales of automobiles rising 5% annually to 26.3 million units. Among India's eight major industries, the oil and gas sector supplies about 35% of the country's energy. India's GDP contribution from the IT sector is projected to be between 7 and 8 percent throughout that time. (Annual reports of respective Industries, Statista)

This research will examine these businesses' financial data to investigate the link between capital structure and financial success metrics, by employing regression analysis, a statistical

method for analyzing the correlations between many factors. A regression analysis will be run to see whether there is a correlation between capital structure and these metrics of monetary health. Purposive sampling will be used to choose a representative sample of publicly traded firms for this research. To have enough information to work with, the study will cover a five-year time frame, from 2019 to 2023.

Research Design:

A descriptive analysis will be carried out to validate the capital structure theories and to provide a detailed overview of the financial performance and capital structure of the selected companies.

Data collection:

The secondary data shall be collected from the CapitalLine database, along with the financial statements and annual reports of the multinational companies, Industry reports, research papers, and academic journals on related topics.

Sample Size:

The data will be taken from the Capital Line database for five years on all the above sectors- the companies are listed on Indian Stock Exchanges. The final data set of companies shall be finalized and shortlisted based on **market capitalisation** greater than Rs. 100 crores. In addition to this, the companies must have debt in their capital structure. The following table gives the details of the data set taken for the study:

Sectors	Total Companies on Capital Line Database
Pharmaceuticals	567
Automobiles	214
Oil & Gas	65
IT	260
FMCG	540
	1646

Table: 1 Companies from all five sectors: Author's compilation

Data Analysis

The data shall be analysed using Descriptive statistics, regression analysis, and correlation analysis.

Population: Companies operating in India in the above-listed sectors.

Sampling Method: A purposive sampling method is used -as this sampling is a category of non-probability sampling approaches where units are chosen based on the qualities required in the sample under study.

Variables and Measurement

The Capital Structure, which is measured using the Debt-to-Equity Ratio (D/E) is the Independent Variable. Whereas, various measures of financial performance like Return on Assets (ROA), Return on Equity (ROE), Return on Investment (ROI), Earnings per share (EPS), Net Profit Margin, Operating Profit Margin, Current Ratio Interest Coverage ratio, Total assets turnover ratio are the Dependent variables.

VIII. EXPECTED OUTCOME OF THE RESEARCH

The findings of the study shall help the policymakers and the management to:

1. Adjust regulatory frameworks to support optimal capital structuring for MNCs, thereby, enhancing financial stability and growth
2. To provide targeted support to sectors where capital structure significantly impacts performance, fostering competitiveness and innovation.
3. Enhance risk management by adjusting to sector-specific insights, diversifying financing sources, and implementing robust financial strategies.
4. Improve investor relations by communicating the strategic importance of their capital structure decisions and their impact on financial performance.

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